

USAWC STRATEGY RESEARCH PROJECT

AUDITABLE FINANCIAL STATEMENTS FOR DOD: ARE WE THERE YET?

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## ABSTRACT

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Achieving auditable financial statements continues to elude the Department of Defense (DOD). Arguably DOD has had accountability problems since inception. In the last two decades legislative reform, attention by senior leadership, and actions by responsible organizations have been aimed towards enhancing financial management within the Government. However, over the last 12 years DOD's financial management reform efforts have failed. Although DOD has made progress, much more work is required to reach a "clean audit opinion."

Examples of DOD's accounting problems include \$1.1 trillion worth of "unsupported" entries that made their way into DOD's financial statements according to DOD IG's audit report for fiscal year 2000 because of poor systems and unreliable documentation of transactions and assets. In another instance, relating to "balancing the checkbook," DOD IG's audit report for fiscal year 2003 revealed an approximate \$20 billion error in balancing DOD's checkbook with Treasury. In addition, to "dollar impact," DOD's poor accountability has also impacted mission accomplishment. Inventory accountability problems resulted in defective chemical garment suits being shipped to U.S. military forces in high-threat areas.

DOD has ramped up its efforts and is now striving to fully develop and implement an enterprise architecture by 2007. Committed support by the President and the Secretary of Defense has provided impetus for financial management reform.

This paper will recognize selected reform efforts toward resolving DOD's problematic financial management history; provide examples of and explore reasons for DOD's accounting problems, and analyze what DOD has accomplished to improve accountability of DOD's financial management.



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## AUDITABLE FINANCIAL STATEMENTS FOR DOD: ARE WE THERE YET?

“Without accountability, how can we ever expect results? Under my Administration, we will bring this cycle of failure to an abrupt end. As President, I will hold all affected agencies accountable for passing their audits not later than 2002. I will say to those I put in place, get your audits right.”

—Governor George W. Bush

The above quote comes from President Bush's 2002 President's Management Agenda. The deadline of 2002 cited above has past—the Department of Defense (DOD) still does not have its “audits right.” The DOD Inspector General (IG) independent auditor's report for fiscal year 2003 disclosed that the “The Under Secretary of Defense (Comptroller)/Chief Financial Officer has acknowledged that (1) DOD financial management systems do not substantially comply with Federal management systems requirements, generally accepted accounting principles, and the U. S. Government Standard General Ledger at the transaction level and (2) DOD financial management and feeder systems cannot currently provide adequate evidence to support various material amounts on the financial statements.” As a result, DOD IG disclaimed an opinion.<sup>1</sup>

Examples of DOD's accounting problems include \$1.1 trillion worth of “unsupported” entries that made their way into DOD's financial statements according to DOD IG's audit report for fiscal year 2000 because of “...poor systems and unreliable documentation of transactions and assets.”<sup>2</sup> In another instance, relating to “balancing the checkbook,” DOD IG's audit report for fiscal year 2003 revealed an approximate \$20 billion error in balancing DOD's checkbook with Treasury. In addition, to “dollar impact,” DOD's poor accountability has also impacted mission accomplishment. Inventory accountability problems resulted in defective chemical garment suits being shipped to U.S. military forces in high-threat areas.

Although the President, Secretary of Defense, and Congress have taken actions to increase accountability, specific efforts need to be sustained to continue the enhancement of DOD's financial management and business modernization efforts. A series of specific financial management reform efforts undertaken by DOD from 1989 to 1997 failed. However, subsequent undertakings since 2000 show DOD having made commendable progress although much more work is still required. Building on this progress, DOD has ramped up its efforts and is now striving to fully develop and implement an enterprise architecture—a DOD-wide blueprint that prescribes how the “...Department's financial and non-financial feeder systems and management processes will interact...”<sup>3</sup> by 2007. Committed support by the President and the Secretary of Defense has provided important impetus toward financial management reform.



This paper will recognize selected reform efforts directed toward resolving DOD's problematic financial management history; provide examples of and explore reasons for DOD's accounting problems, and analyze what DOD has accomplished to improve accountability of DOD's financial management. In addition, it will provide conclusions and recommendations on efforts DOD should sustain or undertake to improve accountability.

## **STRATEGIC IMPERATIVE FOR REFORM**

### **THE REQUIREMENT TO ACCOUNT FOR PUBLIC MONEY**

A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.

—Constitution of the United States, Article I, Section 9

The U.S. Constitution, “the highest law in the land,” establishes the requirement for an accounting of public money but DOD has been unable to meet this requirement. Congress has sought reform targeted at improving financial management within the government; through a series of legislative acts. The President and the Secretary of Defense both have included financial reform in their grand strategies. In turn, their actions have elevated the importance and added impetus for financial reform.

### **LEGISLATIVE REFORM**

During the last 20 years, Congress enacted five public laws aimed at improving federal financial management. In combination, these acts represent significant and comprehensive management reform. Each successive act either adds to or builds upon the former legislation.

**Federal Managers Financial Integrity Act (FMFIA) of 1982:** The FMFIA sought to improve the internal accounting and administrative controls of each executive agency. The controls were to provide reasonable assurance that: (1) obligations and costs are in compliance with applicable law; (2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets. To ensure compliance with these requirements, the act requires agencies to evaluate their systems of internal accounting and administrative controls for compliance. In connection, the agencies must prepare an annual statement that they fully comply with the requirements of this act. If not compliant they must prepare statements and reports that identify any material weaknesses in the agency's systems of internal accounting control and administrative controls. The statement

and reports must include plans and a schedule for correcting any material weakness identified.<sup>4</sup> However, this act barely scratched the surface for achieving accountability— a more complete foundation for reform was needed.

**Chief Financial Officers Act (CFO) of 1990:** The CFO act marked the beginning of a new era in federal management and accountability. In 1991 the General Accounting Office (GAO) published a booklet to help federal financial managers, auditors, and program managers at all levels of government better understand the act. It included this brief synopsis: “This [the CFO Act of 1990] is the most comprehensive and far-reaching financial management improvement legislation since the Budget and Accounting Procedures Act of 1950 was passed over 40 years ago. The CFO Act will lay a foundation for comprehensive reform of federal financial management. The act establishes a leadership structure, provides for long-range planning, requires audited financial statements, and strengthens accountability reporting.”<sup>5</sup> While the act laid the requisite groundwork it was only a pilot program in nature, therefore more direction and guidance was needed to help all agencies generate the appropriate financial statements that reflected the results of their operations.

**Government Management Reform Act (GMRA) of 1994:**<sup>6</sup> The GMRA amended the provisions of the CFO Act and expanded the requirement for audited financial statements to all the executive agencies identified in the CFO act. The GMRA act requires agencies to have comprehensive financial statements that are audited. Specifically, agency financial statements are to reflect the results of agency operations and, beginning with FY 1997, a government-wide financial statement that includes results of government-wide operations.<sup>7</sup> This act is the basis for DOD’s Inspector General to provide audited financial statements to OMB. After this act was passed it became apparent that to produce accurate, timely, or reliable financial statements, the respective agency’s financial managements systems needed substantive “fixing.”

**Federal Financial Management Improvement Act (FFMIA) of 1996:** While the CFO act focused on the leadership structure, long-range planning, and audited financial statements, the FFMIA act built upon it by establishing the “ways” for federal financial management systems. The FFMIA requires that agencies implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the United States Government Standard General Ledger at the transaction level.<sup>8</sup>

**National Defense Authorization Act for Fiscal Year 2003:** This act required DOD to develop a financial management enterprise architecture and a transition plan for implementing the architecture to meet certain requirements by 1 May 2003. Also, this act requires DOD to

control expenditures for financial system improvements while the architecture and transition plan are being developed and after they are completed.<sup>9</sup>

#### GRAND STRATEGISTS PROVIDE IMPETUS FOR REFORM

In the last several years, senior leadership at the Presidential and Secretary of Defense level have underscored the importance of financial reform by recognizing and including the need to enhance DOD's financial management within their grand strategies. Both Congress and GAO have made the President and the Secretary of Defense "painfully aware" that DOD's financial management and business practices have been abysmal. As a result, both have stressed the importance of accountability and provided guidance aimed toward improving financial management. The President's 2002 National Security Strategy (NSS) specifically addressed changing how the DOD is run, especially in financial management.<sup>10</sup> In addition, the President's 2002 Management Agenda recognizes the need and importance of accurate financial information for accountability. The Agenda states: "Without accurate and timely financial information, it is not possible to accomplish the President's agenda to secure the best performance and highest measure of accountability for the American people."<sup>11</sup> The Secretary of Defense calls for modernizing the DOD-wide approach to business information in the 2001 Quadrennial Defense Review (QDR). The QDR recognizes that the department must transform its outdated support structure that includes "DOD's decades old financial systems that are not well interconnected, and accounting and auditing processes would struggle to meet the standards of generally accepted accounting principles."<sup>12</sup>

#### DOD'S ACCOUNTING PROBLEMS — EXAMPLES AND IMPACT

Examples of DOD's accounting problems include \$1.1 trillion worth of "unsupported" entries that made their way into DOD's financial statements according to DOD IG's audit report for fiscal year 2000 because of "...poor systems and unreliable documentation of transactions and assets."<sup>13</sup> In another instance, when DOD attempted to "balance the checkbook," DOD IG's audit report for fiscal year 2003 revealed an approximate \$20 billion error in balancing DOD's checkbook with Treasury. Further, DOD had approximately \$3.6 billion in uncollected debt related to a variety of contract payment problems due to weak systems and controls. Finally, the last example describes DOD's poor accountability over inventory that resulted in defective chemical garment suits being shipped to U.S. military forces in high-threat areas.

## WHERE DOES THE MONEY GO?

A former house staff member, Kelly Patricia O'Meara, now an investigative reporter for Insight Magazine wrote a provocative article on DOD's financial problems, "Rumsfeld Inherits Financial Mess." In it she discussed DOD's inability to support \$1.1 trillion<sup>14</sup> in accounting entries. According to the article, the deputy DOD IG admitted that \$4.4 trillion in adjustments to the Pentagon's books had to be "cooked" to compile the required financial statements and that \$1.1 trillion [25 percent] of that amount could not be supported by reliable information. "...more than \$1 trillion was simply gone and no one can be sure of when, where or to whom the money went."<sup>15</sup> In other words, "... [the] accounting entries of \$1.1 trillion were made to force financial data to agree with various sources without adequate research and reconciliation, were made to force buyer and seller data to agree in preparation for eliminating entries, did not contain adequate audit trails and documentation, or did not follow accounting principles."<sup>16</sup> This example highlights DOD's inability to produce accurate and reliable information. This results in a loss of credibility with both the taxpayer and Congress who wonder where the money goes; decision makers at all levels who can not rely on the information; and increases vulnerability to fraud, waste, and abuse with systems that lack support for its accounting transactions.

Another example involves a concept that is similar to individuals reconciling their checkbooks with their bank statements. In this case DOD was billions of dollars "off the mark." Specifically, the DOD Inspector General (IG) independent auditor's report for fiscal year 2003 disclosed that substantial inconsistencies existed in reporting Fund Balance with Treasury. The U.S. Treasury Financial Manual and DOD Financial Management Regulation 7000.14-R has a requirement to resolve financial and accounting inconsistencies to accurately report Fund Balance with Treasury. The value of the inconsistencies amounted to approximately \$20.6 billion as of 31 March 2003. DOD IG deemed this as presenting a major internal control problem.<sup>17</sup> These funding inconsistencies leave DOD with a problem of not truly knowing the amount of funding available. In a GAO report on DOD financial management, GAO states "Until the department can effectively reconcile its available fund balances and Treasury's, ensure that payments are posted to the correct appropriation accounts, and post amounts held in suspense accounts to the proper appropriation accounts, the department will have little assurance that reported appropriation balances are correct. Such information is essential for DOD and the Congress to determine if funds are available that could be used to reduce current funding requirements or that could be reprogrammed or transferred to meet other critical program needs."<sup>18</sup>

DOD has had a history of overpayment to contractors due to a lack of financial accountability and financial management information. Since GAO reported on Department of Defense (DOD) contractor overpayments in 1994, they have issued additional reports highlighting billions of dollars of overpayments to Defense contractors.<sup>19</sup> In a May 2002 GAO report on DOD contract management, the report discusses how DOD continues to overpay contractors. In fiscal year 2001 contractors refunded DOD \$488 million in overpayments.<sup>20</sup> The full extent of overpayments according to GAO is not known. GAO pointed out that “[t]his amount might not reflect total improper payments DOD made to contractors because contract reconciliation is likely to identify additional overpayments. Further, ... this amount represents a sizable amount of cash in the hands of contractors beyond what is intended to finance and pay for the goods and services DOD purchases, and is indicative of the need for stronger internal controls within the payment system.”<sup>21</sup> Effective controls over this area are important otherwise, as GAO pointed out “...DOD will continue to risk erroneously paying contractors millions of dollars and incur additional, unnecessary costs to collect amounts owed from contractors.”<sup>22</sup> In addition, DOD’s weak systems and controls leave the department vulnerable to fraud and improper payments.

Aside from a dollar impact, poor accountability can adversely effect mission accomplishment in the defense of our national interests. In addition, as the following examples of “chem-bio suits” will illustrate, poor accountability can potentially put people “in harms way.” In a June 2003 GAO testimony on the status of financial management within DOD, GAO disclosed that DOD and its military services did not know how many Joint Service Lightweight Integrated Suit Technology (JLIST)<sup>23</sup> suits they had, their condition, and where they were located. This occurred due to several factors that included the use of nonstandard, nonintegrated, stovepiped systems. The methods to control JLIST ranged from stand-alone automated systems, to spreadsheet applications, to pen and paper, to nothing at all. Consequently, DOD believed it had excess suits and sold them on the Internet for “pennies on the dollar” while simultaneously purchasing hundreds of thousands of new chem-bio suits annually.<sup>24</sup> In the same June 2003 testimony, GAO also described a similar event with the Defense Logistics Agency (DLA). DLA had problems identifying and removing defective Battle Dress Overgarments (BDO)<sup>25</sup> from inventory. As a result, some of the defective garments were shipped to U.S. forces in high-threat areas. Furthermore, GAO reported that in a June 2000 testimony, the DOD IG pointed out that a physical count of BDOs could not locate 420,000 of the protective suits recorded in DLA’s accountability database.<sup>26</sup>

## REASONS FOR DOD'S ACCOUNTING PROBLEMS

Arguably a myriad of reasons exist for the problems that hinder DOD from complying with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. However, in searching for a center of gravity a consistent theme emerges from the various government reports and studies. In essence, with its vast and complex array of “business systems” DOD has lacked an overarching integrated business strategy—financial management being a subset.

The sheer size and complexity of DOD is unlike any other organization. DOD's Business Management Modernization Program web site provides the following: “With over \$1 trillion in assets, an annual budget of \$378 billion and over 3 million military and civilian employees, the Department of Defense (DOD) is the world's largest and most diversified enterprise.”<sup>27</sup> DOD also reports responsibility for maintaining an infrastructure of more than 600,000 individual buildings and structures located at more than 6,000 different locations and using more than 30 million acres. In addition, for fiscal year 2002, DOD operated and maintained about 250,000 vehicles, over 15,000 aircraft, more than 1,000 oceangoing vessels, and some 550 public utility systems.<sup>28</sup> To aid in managing the size and complexity of its organization, DOD has an inventory of 2,300 disparate business systems for its day-to-day operations.<sup>29</sup>

The reason these disparate systems have been allowed to grow is the absence of a systematic and coordinated departmentwide strategy—a lack of an overarching approach to financial management. The question of how did DOD's “amalgamation” of 2,300 systems come about is described in a GAO report on DOD business systems modernization: “As we have previously reported, this systems environment is not the result of a systematic and coordinated departmentwide strategy, but rather is the product of unrelated, stovepiped initiatives to support a set of business operations that are nonstandard and duplicative across DOD components.”<sup>30</sup> The lack of an overarching approach is identified in what is frequently referred to as the “Friedman Study.” This study was named after Stephen Friedman, retired chairman and senior partner of Goldman Sachs & Co. Mr. Friedman was part of a six-member study group, appointed by Defense Secretary Donald Rumsfeld as part of his strategic review of DOD's Financial Management.<sup>31</sup> The 2001 Friedman study cited a “Lack of an overarching approach to financial management...” as one of the challenges DOD was facing. Specifically, the study stated, “No single authoritative source is currently addressing, from a strategic and programmatic level, the key issues from an end-to-end approach. This includes addressing incompatible and technologically-dated systems, and defining and standardizing the financial requirements and managerial data needed for reporting and decision-making. A void exists in

the organizational structure with respect to developing and implementing an overall financial management strategy."<sup>32</sup>

Included as a component of any overall financial management strategy is an enterprise-wide architecture. The absence of such an architecture within the DOD has served as a major stumbling block in complying with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. Enterprise architecture goals, among others, would seek to integrate and standardize DOD's 2,300 disparate systems as described in a GAO 2003 report on DOD business systems modernization. Specifically, the report states, "DOD's amalgamation of systems is characterized by (1) multiple systems performing the same tasks; (2) the same data stored in multiple systems; (3) manual data entry and reentry into multiple systems; and (4) extensive data translations and interfaces, each of which increases costs and limits data integrity. GAO further states, as we have reported, these systems do not produce reliable financial data to support managerial decision making and ensure accountability."<sup>33</sup> Prior to DOD developing its initial version of an enterprise architecture, GAO cogently captured the impact of DOD not having developed such an architecture:

*Lack of departmentwide enterprise architecture:* DOD does not yet have an architecture, or blueprint, to guide and constrain its business systems investments across the department. Nevertheless, DOD continues to spend billions of dollars on new and modified systems based [on] the parochial needs and strategic directions of its component organizations. This will continue to result in systems that are duplicative, are not integrated, are unnecessarily costly to maintain and interface, and will not adequately address longstanding financial management problems.<sup>34</sup>

The importance of an enterprise architecture must be underscored and recognized. It is to serve as a road map for transformation of DOD business operations in support of the warfighter.<sup>35</sup> Enterprise architecture is a necessary and important roadmap. It is as important to an organization's operations and systems as a set of blueprints is to a building. This metaphor is described in an Executive Guide published by the U.S. General Accounting Office (GAO): "That is, building blueprints provide those who own, construct, and maintain the building with a clear and understandable picture of the building's uses, features, functions, and supporting systems, including relevant building standards. Further, the building blueprints capture the relationships among building components and govern the construction process. Enterprise architectures do nothing less, providing to people at all organizational levels an explicit, common, and meaningful structural frame of reference that allows an understanding of (1) what the enterprise does; (2) when, where, how, and why it does it; and (3) what it uses to

do it."<sup>36</sup> Hence an enterprise architecture is needed to achieve greater internal efficiencies, streamline business operations, and improve inter-agency collaboration. In addition, the use of architectures is a crucial means to a challenging end: agency operational structures that are optimally defined, in both business and technological environments. The alternative is an undesirable "...perpetuation of the kinds of operational environments that saddle most agencies today in which lack of integration among business operations and supporting information technology (IT) resources leads to inefficiencies and duplication."<sup>37</sup>

## **ANALYSIS OF WHAT DOD HAS ACCOMPLISHED**

This section will briefly review DOD's past reform efforts which have been unsuccessful at improving financial management. Additionally, this section will analyze DOD's current reform efforts which show progress but with much work remaining.

### **PAST FAILED REFORM EFFORTS**

Specific financial reform Efforts undertaken by DOD from 1989 to 1997 have been unsuccessful in developing a systematic and coordinated strategy to improve financial management. As chronicled in a GAO 2002 report on financial management reform, DOD initiated several broad-based department-wide reform efforts during this period. These efforts were intended to fundamentally reform its financial operations as well as other key business areas. The Defense Reform Initiative, the Defense Business Operations Fund, and the Corporate Information Management initiative have proven to be unsuccessful despite good intentions and substantial effort. Conditions remain unchanged today that led to these previous attempts at reform. These efforts, as described in the GAO report, are highlighted below.<sup>38</sup>

**Corporate Information Management (CIM).** In 1989, the CIM initiative began with the intent to save billions of dollars by streamlining operations and implementing standard information systems to support common business operations. DOD expected CIM to reform all of DOD's functional areas through consolidation, standardization, and integration. In addition, CIM was expected to replace approximately 2000 duplicative systems. After DOD essentially wasted and mismanaged billions of dollars, CIM was discarded. Consequently, GAO severely criticized DOD and stated:

"Over the years, we made numerous recommendations to improve CIM's management to help preclude the wasteful use and mismanagement of billion[s] of dollars. However, these recommendations were generally not addressed. Instead, DOD spent billions of dollars with little sound analytical justification. Rather than relying on a rigorous decision-making process for information technology investments—as used in leading private and public organizations we studied, DOD made systems decisions without (1) appropriately analyzing cost,



benefits, and technical risks; (2) establishing realistic project schedules; or (3) considering how business process improvements could affect information technology investments. For one effort alone, DOD spent about \$700 million trying to develop and implement a single system for the material management business area— but this effort proved unsuccessful. We reported in 1997 that the benefits of CIM had yet to be widely achieved after 8 years of effort and spending about \$20 billion. The CIM initiative was eventually abandoned."<sup>39</sup>

**Defense Business Operations Fund (DBOF).** In October 1991, DOD established DBOF by consolidating nine existing industrial and stock funds and five other activities operated throughout DOD. The intent of DBOF was to bring greater DOD visibility and management to the overall cost for certain critical DOD business operations. However, GAO pointed out that since DBOF's inception, it lacked the policies, procedures, and financial systems to operate in a businesslike manner. In 1996, DOD eliminated DBOF by replacing it with four working capital funds. However, these funds inherited the same operational and financial reporting problems. GAO's review of these funds disclosed that they still do not provide accurate and timely information on the results of operations. As a result, fund customers cannot be assured that prices charged for goods and services represent actual costs.<sup>40</sup>

**Defense Reform Initiative (DRI).** In November 1997, the then Secretary of Defense stated that his goal was "to ignite a revolution in business affairs." DRI represented a set of proposed actions aimed at improving the effectiveness and efficiency of DOD's business operations. Particularly, in the areas that had been long-standing problems including financial management. Although DRI got off to a good start, GAO noted that in implementing many of the component initiatives, DOD did not meet expected time frames and goals. The extent to which savings would be realized was yet to be determined. A notable barrier that kept the department from meeting its time frames and goals is what GAO referred to as "institutional resistance" to change. In addition, GAO pointed out that DOD did not have a clear roadmap to ensure that the interrelationships between the major reform efforts were understood nor to clarify DOD's investing priorities.<sup>41</sup>

Has DOD learned from this history of past failures in trying to achieve efficiency and effectiveness in its business operations and to assure accurate and timely information? By any measure CIM's was a monumental failure. Keep in mind that CIM's intent of streamlining operations and implementing standard information systems to support common business operations is similar to what DOD is attempting to accomplish today. Is DOD listening to the past and present recommendations of GAO and other studies? More importantly is DOD responsive?

## DOD GETS SERIOUS

DOD is in earnest with its financial management reform efforts. This section will discuss three strategic actions that DOD has taken or is undertaking. First, DOD senior leadership has affirmed its support for financial management reform by making reform a high priority. Second, to meet the need for a departmentwide strategy, DOD established the Financial Management Modernization Program (FMMP). FMMP is responsible for developing the DOD-wide Business Enterprise Architecture (BEA). The importance of this enterprise architecture has resulted in DOD putting forth significant effort for its development. Congress via GAO is closely monitoring DOD's progress toward developing and implementing the enterprise architecture. Third, DOD has taken initial steps to control business systems investments in response to GAO's criticism of "parochial investment decisions" by component services as a constraint to implementing the architecture.

Successful financial management reform requires senior leadership support. The Freidman Study identified leadership as central to improving DOD's financial management. The study called for "...establishing a SECDEF and senior leadership high priority for financial information transformation..."<sup>42</sup> DOD responded when Secretary Rumsfeld answered the call in a 19 July 2001 memorandum. He declared that one of his highest priorities was to have "reliable and timely financial information upon which to make the most effective business decisions;..."<sup>43</sup> In a follow-on 24 September 2003 memorandum, Secretary Rumsfeld placed financial management on his top 10 list of legislative priorities for fiscal year 2005.<sup>44</sup>

As discussed earlier, an overarching approach to financial management was needed. Secretary Rumsfeld established the Financial Management Modernization Program (FMMP) in July 2001.<sup>45</sup> In a 2001 memorandum on Financial Management Information within the Department of Defense, Secretary Rumsfeld directed that a Program Management Office (PMO) be established that would report to the Undersecretary of Defense (Comptroller). The PMO would develop an enterprise architecture and be responsible within the Defense Acquisition System for control and oversight of development, acquisition, upgrade, deployment, and other changes for all financial management systems and related nonfinancial business systems to include legacy systems.<sup>46</sup> In recognition "...that financial management is a crosscutting issue that effects virtually all DOD business areas,"<sup>47</sup> the Undersecretary of Defense renamed the FMMP to the Business Management Modernization Program (BMMP) in a May 2003 memorandum.<sup>48</sup> The BMMP was established to address the department's financial management challenges, as part of a comprehensive integrated DOD-wide business process reform and develop the DOD-wide Business Enterprise Architecture (BEA).<sup>49</sup>

In response to GAO and Freidman's study that included a recommendation for a DOD-wide Business Enterprise Architecture (BEA), the 2001 Quadrennial Defense Review specifically calls for DOD to "create a Department-wide blueprint (enterprise architecture) that will prescribe how the Department's financial and non-financial feeder systems and management processes will interact. This architecture will guide the development of enterprise level processes and systems throughout DOD."<sup>50</sup> The National Defense Authorization Act for Fiscal Year 2003 put more teeth and a deadline into the GAO's recommendations for DOD to develop an enterprise. As noted earlier in this report, the act required DOD to develop an enterprise architecture and a transition plan for implementing the architecture by 1 May 2003. In meeting its responsibility for developing the BEA the BMMP established a Business Management Modernization Web Site that identifies the following strategy: <sup>51</sup>

1. Build a DoD-wide architecture and transition plan that prescribe the implementation and use of standard business and financial rules,
2. Employ a DoD-wide oversight process, consisting of DoD's senior leadership, to implement the architecture and to monitor Departmental spending,
3. Refine and extend the architecture to create a seamless connection between it and other Federal and DoD transformation initiatives,
4. Complete the development and implementation of the governance oversight process.<sup>52</sup>

DOD has put forth significant effort to develop and implement its first version of the BEA. To its credit, version 1.0 of the architecture was delivered on schedule and under budget on 20 April 2003.<sup>53</sup> Although DOD has moved forward with its efforts, much more work lies ahead. GAO acknowledged DOD's progress and cited: "...DOD has expended tremendous effort and resources and made important progress in complying with the legislative requirements aimed at developing and effectively implementing a well-defined enterprise architecture."<sup>54</sup> However, according to a GAO report on DOD business systems modernization, DOD's "version 1.0" of its architecture did not yet adequately address the National Defense Authorization Act's requirements and other relevant architectural requirements. Specifically, the GAO's report cited as an example of what was lacking, "...the architecture does not adequately describe the accounting and financial management requirements and the logical database model, which includes data standards and is used to guide the creation of the physical databases where information will be stored."<sup>55</sup> In addition, the report recognized that DOD had taken "...a positive first step, but much remains to be accomplished before DOD will have the kind of blueprint and

associated controls to successfully modernize its business operations and supporting systems.<sup>156</sup>

DOD was responsive in answering GAO's evaluation of the initial architecture.<sup>57</sup> In essence, DOD disclosed that it will follow an incremental approach as advised by GAO.<sup>58</sup> DOD's approach is to focus on reengineering its business processes followed by selection of the business systems solutions. "The first increment will implement the foundation of the architecture and key business processes. Examples are the use of the United States Standard General Ledger, a standard accounting code structure, data standards, storage and retrieval of data, and logistics processes coupled with the related acquisition and accounting processes."<sup>59</sup>

A primary implementation challenge associated with enterprise architecture is that DOD component organizations simply find it contrary to their parochial interests. The GAO cites this cultural resistance as a substantial risk to successful development and implementation of an enterprise architecture.<sup>60</sup> In a February 2003 report GAO cited that although DOD had taken some initial steps to improve its management of business system investments<sup>61</sup> it has not been more successful because component organizations, throughout DOD were continuing "to make parochial investment decisions and following different approaches and criteria."<sup>62</sup> As a result, "...this stovepiped decision-making process has contributed to the department's current complex, error-prone environment..."<sup>63</sup>

DOD has somewhat addressed GAO's concerns regarding parochial investment decisions. In a GAO summary assessment of DOD's initial Business Enterprise Architecture,<sup>64</sup> the Undersecretary of Defense (USD) Comptroller responded to GAO's recommendations regarding business systems investments. USD answered GAO by recognizing the need to manage and control DOD's ongoing and planned business systems investment. Specifically, USD disclosed their approach was defined in the draft DOD Directive, "Information Technology (IT) Capital Planning and Investment Control (CPIC) Portfolio Management" and draft DOD Instruction, "Operation of the IT CPIC Portfolio Management System."<sup>65</sup> However, according to the GAO report, DOD had not provided the draft directive to GAO for evaluation. Consequently, GAO could not determine whether the draft addresses the limitations of DOD's existing approach. This approach invests DOD business line representatives (such as those in logistics, acquisition, and human resource management) referred to as domain owners with the authority, responsibility, and accountability for implementation of the architecture and investment portfolio management for their domains. However, according to GAO it was unclear how the proposed approach would be implemented. Additionally, GAO questioned how the domain owners would "...ensure consistency across domains for architecture extensions and changes..."<sup>66</sup> and how

the approach would address GAO's prior recommendations for "...establishing a hierarchy of investment review boards that use an explicit and common set of criteria for selecting, controlling, and evaluating IT projects as a portfolio of competing investment options."<sup>67</sup>

#### ARE WE THERE YET?

How long before DOD can implement the architecture and achieve auditable statements? Secretary Rumsfeld has estimated that achieving desired financial management and related business transformation goals that rely on longer term system improvements may take 8 or more years. In a testimony on DOD financial management, GAO acknowledged this was "not an unrealistic estimate" based on their research experience with other federal agencies.<sup>68</sup> However, the National Defense Authorization Act for Fiscal Year 2003 identifies a target date of 2007 for DOD to develop and implement its enterprise architecture. In conjunction, it also requires the Secretary of Defense to submit a report to Congress not later than March 15 of each year from 2004 through 2007. The purpose of the report is for DOD to describe its progress in implementing the enterprise architecture and transition plan.<sup>69</sup>

#### CONCLUSIONS AND RECOMMENDATIONS

Auditable financial statements for DOD—Are we there yet? No, and the answer to when we will arrive is at best an educated guess. Yes, DOD is listening and responding to the recommendations of GAO and other studies. DOD has responded by providing senior leadership support, developing an initial enterprise architecture, and controlling business systems investment. DOD's responsiveness is due in part to senior leadership support and legislative pressure. Current senior leadership has recognized that improving accountability within DOD is simply the "right thing to do." Senior leaders are committed via the inclusion of financial reform within their grand strategies. Through the National Defense Authorization Act for Fiscal Year 2003, some of GAO's past recommendations, such as developing and implementing an enterprise architecture have become requirements.

In this election year sustaining senior leadership support is important. DOD faces the potential for a new Secretary of Defense who may have a different set of priorities for DOD. Regardless whether Mr. Rumsfeld remains or is replaced, financial management reform should remain on the Secretary of Defense's top 10 list of priorities in order to clearly demonstrate senior leadership's support.

Although it "took an act of Congress," DOD has reached a key milestone with version 1.0 of its enterprise architecture that lays the foundation needed to develop a well-defined business enterprise architecture. DOD should be commended for reaching this milestone on schedule

and under budget and for the progress made toward a fully developed architecture. This success coupled with the importance of an enterprise architecture should compel and provide the urgency for DOD to swiftly address both the National Defense Authorization Act's requirements and adopt GAO's architectural recommendations. As a result, DOD should continue with its incremental approach toward full development and implementation of the DOD-wide Business Enterprise Architecture. DoD should ensure the architecture adequately describes the accounting and financial management requirements and, among others, addresses the use of the United States standard General Ledger, a standard accounting code structure, data standards, and, storage and retrieval of data.

Controlling the money for DOD's ongoing and planned business systems investment is the key to eliminating parochial investment decisions. Allowing component organizations throughout DoD to make parochial investments is an impediment to implementing an enterprise architecture. GAO's questions and recommendations regarding DOD's business investment decisions make sense. Specifically, DOD does need to ensure consistency across domains for architecture extensions and changes. In addition, DOD needs to control the money for IT projects by establishing a hierarchy of investment review boards that uses an explicit and common set of criteria for selecting, controlling, and evaluating IT projects. DOD may have an alternative approach but at a minimum should have an explicit and common set of criteria for selecting, controlling, and evaluating business systems investment.

DOD should be applauded for its tremendous efforts and encouraged, and at times pressured, to continue its endeavors to transform DOD's business operations. Specifically, among many other required actions, DOD should become a credible steward for "public money" by improving accountability. Ensuring effective accountability will ultimately result in auditable financial statements. GAO effectively narrates the "**bottom line:**"

"With the events of September 11, and the federal government's short- and long-term budget challenges, it is more important than ever that DOD effectively transform its business operations to ensure that it gets the most from every dollar spent. The department must be able to effectively carry out its stewardship responsibilities for the funding it receives and for the vast amount of equipment and inventories used in support of military operations. Even before the events of September 11, increased globalization, changing security threats, and rapid technological advances were prompting fundamental changes in the environment in which DOD operates. These trends place a premium on increasing strategic planning, enhancing results orientation, ensuring effective accountability, maintaining transparency, and using integrated approaches."<sup>70</sup>

In summary, to keep DOD's momentum the following actions are recommended:

- Ensure top leadership support. This is critical for continued success. This must be affirmed by financial management reform remaining on DOD's top 10 priority list.
- Pursue full development and implementation of the DOD-wide Business Enterprise Architecture via an incremental approach. In the appropriate increment ensure the architecture adequately describes the accounting and financial management requirements. Among others, address the use of the United States standard General Ledger, a standard accounting code structure, data standards, and. storage and retrieval of data.
- Control the money. Both the DOD draft directive, "Information Technology (IT) Capital Planning and Investment Control (CPIC) Portfolio Management" and draft DOD Instruction, "operation of the IT CPIC Portfolio Management System" prior to finalization and implementation, be evaluated for effectiveness and efficiency. The evaluation should include whether the system meets the criterion identified by GAO.

WORD COUNT= 6,295

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<sup>2</sup> Kelly Patricia O'Meara, "Rumsfeld Inherits Financial Mess," *Insight Magazine*, August 10 2001; available from <<http://www.insightmag.com/main.cfm?include=detail&storyid=139530>>; Internet, accessed 30 December 2003.

<sup>3</sup> Department of Defense, *Quadrennial Defense Review Report* (Washington, D.C.: Department of Defense, 30 September 2001), 55.

<sup>4</sup> *Federal Managers Financial Integrity Act of 1982*; available from <<http://www.whitehouse.gov/omb/financial/fmia1982.html>>; Internet, accessed 15 October 2003.

<sup>5</sup> General Accounting Office, *The Chief Financial Officers Act, A Mandate for Federal Financial Management Reform* (Washington, D.C.: U.S. General Accounting Office, September 1991), 1.

<sup>6</sup> The short title for the financial management section of the GMRA act may also be cited as the "Federal Financial Management Act of 1994".

<sup>7</sup> *Government Management Reform Act of 1994*; available from <<http://www.govworks.gov/client/5401a5.pdf>>; Internet, accessed 15 October 2003.

<sup>8</sup> *Federal Financial Management Improvement Act (FFMIA) of 1996*; available from <<http://www.dod.mil/comptroller/icenter/inforef/ffmia96.pdf>>; Internet, accessed 15 October 2003.

<sup>9</sup> *Bob Stump National Defense Authorization Act for Fiscal Year 2003*, Public Law No. 107-314, § 1004, 116 Stat. 2629, 2 December 2002.

<sup>10</sup> George W. Bush, *National Security Strategy of the United States of America* (Washington, D.C.: The White House, September 2002), 30.

<sup>11</sup> George W. Bush, *The President's Management Agenda* (Washington, D.C.: U.S. Government Printing Office, 2002), 20.

<sup>12</sup> Department of Defense, *Quadrennial Defense Review Report* (Washington, D.C.: Department of Defense, 30 September 2001), 49.

<sup>13</sup> Kelly Patricia O'Meara, "Rumsfeld Inherits Financial Mess," *Insight Magazine*, August 10 2001; available from <<http://www.insightmag.com/main.cfm?include=detail&storyid=139530>>; Internet, accessed 30 December 2003.

<sup>14</sup> Kelly Patricia O'Meara, "Rumsfeld Inherits Financial Mess," *Insight Magazine*, August 10 2001; available from



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<sup>15</sup> Kelly Patricia O'Meara, "Rumsfeld Inherits Financial Mess," *Insight Magazine*, August 10 2001; <<http://www.insightmag.com/main.cfm?include=detail&storyid=139530>>; Internet, accessed 30 December 2003.

<sup>16</sup> Department of Defense, Inspector General, *Compilation of the FY 2000 DoD Agency-Wide Financial Statements*, 19 September 2001; available from <<http://www.dodig.osd.mil/audit/reports/fy01/01-181.pdf>>; Internet, accessed 8 January 2004.

<sup>17</sup> Department of Defense, Inspector General, *Independent Auditor's Report on the Department of Defense Fiscal Year 2003 Agency-Wide Principal Financial Statements*, 10 December 2003; available from <<http://www.dodig.osd.mil/audit/reports/04report.htm>>; Internet, accessed 8 January 2004.

<sup>18</sup> General Accounting Office, *DoD Financial Management: Testimony, Before the Subcommittee on Financial Management and Intergovernmental Relations, Committee on Government Reform, House of Representatives* (Washington, D.C.: U.S. General Accounting Office, 8 May 2001), 3.

<sup>19</sup> General Accounting Office, *DOD Contract Management Overpayments Continue and Management and Accounting Issues Remain* (Washington, D.C.: U.S. General Accounting Office, May 2002), 1.

<sup>20</sup> General Accounting Office, *DOD Contract Management Overpayments Continue and Management and Accounting Issues Remain* (Washington, D.C.: U.S. General Accounting Office, May 2002), 6.

<sup>21</sup> General Accounting Office, *Financial Management: Coordinated Approach Needed to Address the Government's Improper Payments Problems* (Washington, D.C.: U.S. General Accounting Office, August 2002), 13.

<sup>22</sup> General Accounting Office, *DOD Financial Management Integrated Approach, Accountability, and Incentives are Keys to Effective Reform; Testimony, Before the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations, Committee on Government Reform, House of Representatives* (Washington, D.C.: U.S. General Accounting Office, 8 May 2001), 7.

<sup>23</sup> JLIST is a universal, lightweight, two-piece garment (coat and trousers) that when combined with footwear, gloves, and protective mask and breathing device, forms the war fighter's protective ensemble. Together the ensemble is to provide maximum protection to the war fighter against chemical and biological contaminants without negatively impacting the ability to perform mission tasks.

<sup>24</sup> General Accounting Office, *Department of Defense Status of Financial Management Weaknesses and Progress Toward Reform; Testimony, Before the Subcommittee Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives* (Washington, D.C.: U.S. General Accounting Office, 25 June 2003), 6.

<sup>25</sup> Battle Dress Overgarments (BDOs) were the predecessor to the Joint Service Lightweight Integrated Suite Technology (JLIST).

<sup>26</sup> General Accounting Office, *Department of Defense Status of Financial Management Weaknesses and Progress Toward Reform; Testimony, Before the Subcommittee Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives* (Washington, D.C.: U.S. General Accounting Office, 25 June 2003), 6.

<sup>27</sup> Department of Defense, Business Management Modernization Web Site, available from <<http://www.dod.mil/comptroller/bmmp/pages/transition.html>>; Internet, accessed 28 January 2004.

<sup>28</sup> Department of Defense, *Performance and Accountability Report: Fiscal Year 2003*, 23 December 2003, 4; available from <[http://www.defenselink.mil/comptroller/par/fy2003/00\\_Entire\\_Document.pdf](http://www.defenselink.mil/comptroller/par/fy2003/00_Entire_Document.pdf)>; Internet; accessed 22 February 2004.

<sup>29</sup> General Accounting Office, *DoD Business Systems Modernization: Important Progress Made to Develop Business Enterprise Architecture, but Much Work Remains* (Washington, D.C.: U.S. General Accounting Office, September 2003), 3.

<sup>30</sup> General Accounting Office, *DoD Business Systems Modernization: Longstanding Management and Oversight Weaknesses Continue to Put Investments at Risk; Testimony, Before the House Subcommittee on National Security, Emerging Threats, and International Relations, and Subcommittee on Technology, Information Policy, Intergovernmental Relations and Census, Government Reform Committee* (Washington, D.C.: U.S. General Accounting Office, March 2003), 4.

<sup>31</sup> Stephen Friedman, "Special DoD News Briefing on Financial Management Study," United States Department of Defense, News Transcript, 10 July 2001; available from <[http://www.defenselink.mil/news/Jul2001/t07112001\\_t710frie.html](http://www.defenselink.mil/news/Jul2001/t07112001_t710frie.html)>; Internet, accessed 11 November 2003.

<sup>32</sup> Stephen Friedman, "Transforming Department of Defense Financial Management, A Strategy for Change," 13 April 2001; available from <[http://www.defenselink.mil/news/Jul2001/n07112001\\_200107114.html](http://www.defenselink.mil/news/Jul2001/n07112001_200107114.html)>; Internet, accessed 11 November 2003.

<sup>33</sup> General Accounting Office, *DoD Business Systems Modernization: Longstanding Management and Oversight Weaknesses Continue to Put Investments at Risk; Testimony, Before the House Subcommittee on National Security, Emerging Threats, and International Relations, and Subcommittee on Technology, Information Policy, Intergovernmental Relations and Census, Government Reform Committee* (Washington, D.C.: U.S. General Accounting Office, March 2003), 4.

<sup>34</sup> General Accounting Office, *DoD Business Systems Modernization: Longstanding Management and Oversight Weaknesses Continue to Put Investments at Risk; Testimony, Before the House Subcommittee on National Security, Emerging Threats, and International Relations, and Subcommittee on Technology, Information Policy, Intergovernmental Relations and Census, Government Reform Committee* (Washington, D.C.: U.S. General Accounting Office, March 2003), 4.

<sup>35</sup> Department of Defense, *Financial Management Modernization Program, Financial Management Enterprise Architecture, Overview and Summary Information*, Call 0006, Task 6, Update #2, Version 4.9 Final 2 April 2003, 3; available from <<http://www.dod.mil/comptroller/bmmp/products/architecture/av1.doc>>; Internet, accessed 22 February 2004.

<sup>36</sup> General Accounting Office, *Information Technology, A Framework for Assessing and Improving Enterprise Architecture Management (Version 1.1): Executive Guide* (Washington, D.C.: U.S. General Accounting Office, April 2003), i.

<sup>37</sup> General Accounting Office, *Information Technology, A Framework for Assessing and Improving Enterprise Architecture Management (Version 1.1): Executive Guide* (Washington, D.C.: U.S. General Accounting Office, April 2003), i.

<sup>38</sup> General Accounting Office, *DoD Financial Management: Important Steps Underway But Reform Will Require a Long-term Commitment, Testimony, Before the Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform, House of Representatives* (Washington, D.C.: U.S. General Accounting Office, June 2002), 3.

<sup>39</sup> General Accounting Office, *DoD Financial Management: Important Steps Underway But Reform Will Require a Long-term Commitment, Testimony, Before the Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform, House of Representatives* (Washington, D.C.: U.S. General Accounting Office, June 2002), 4.

<sup>40</sup> General Accounting Office, *DoD Financial Management: Important Steps Underway But Reform Will Require a Long-term Commitment, Testimony, Before the Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform, House of Representatives* (Washington, D.C.: U.S. General Accounting Office, June 2002), 4.

<sup>41</sup> General Accounting Office, *DoD Financial Management: Important Steps Underway But Reform Will Require a Long-term Commitment, Testimony, Before the Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform, House of Representatives* (Washington, D.C.: U.S. General Accounting Office, June 2002), 3.

<sup>42</sup> Stephen Friedman, "Transforming Department of Defense Financial Management, A Strategy for Change," 13 April 2001, iii; available from <[http://www.defenselink.mil/news/Jul2001/n07112001\\_200107114.html](http://www.defenselink.mil/news/Jul2001/n07112001_200107114.html)>; Internet, accessed 11 November 2003.

<sup>43</sup> Secretary of Defense Donald Rumsfeld. "Financial Management Information within the Department of Defense," memorandum for Secretaries of the Military Departments, Chairman of the Joint Chiefs of staff, Directors of the Defense agencies (and others), Washington, D.C., 19 July, 2001, 1.

<sup>44</sup> Secretary of Defense Donald Rumsfeld, "Legislative Priorities for Fiscal Year 2005," memorandum for Secretaries of the Military Departments, Chairman of the Joint Chiefs of staff, Directors of the Defense agencies (and others), Washington, D.C., 24 September, 2001, 1.

<sup>45</sup> Secretary of Defense Donald Rumsfeld. "Financial Management Information within the Department of Defense," memorandum for Secretaries of the Military Departments, Chairman of the Joint Chiefs of staff, Directors of the Defense agencies (and others), Washington, D.C., 19 July, 2001, 1.

<sup>46</sup> Secretary of Defense Donald Rumsfeld. "Financial Management Information within the Department of Defense," memorandum for Secretaries of the Military Departments, Chairman of the Joint Chiefs of staff, Directors of the Defense agencies (and others), Washington, D.C., 19 July, 2001, 1.

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<sup>53</sup> Department of Defense, Business Management Modernization Web Site; available from <<http://www.dod.mil/comptroller/bmmp/pages/overview.html>>; Internet, accessed 28 January 2004.

<sup>54</sup> General Accounting Office, *Business Systems Modernization: Summary of GAO's Assessment of the Department of Defense's Initial Business Enterprise Architecture* (Washington, D.C.: U.S. General Accounting Office, 7 July 2003), 3.

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<sup>59</sup> General Accounting Office, *Business Systems Modernization: Summary of GAO's Assessment of the Department of Defense's Initial Business Enterprise Architecture* (Washington, D.C.: U.S. General Accounting Office, 7 July 2003), 17.

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<sup>67</sup> General Accounting Office, *Business Systems Modernization: Summary of GAO's Assessment of the Department of Defense's Initial Business Enterprise Architecture* (Washington, D.C.: U.S. General Accounting Office, 7 July 2003), 8.

<sup>68</sup> General Accounting Office, *DoD Financial Management: Important Steps Underway But Reform Will Require a Long-term Commitment, Testimony, Before the Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform, House of Representatives* (Washington, D.C.: U.S. General Accounting Office, June 2002), 16.

<sup>69</sup> *Bob Stump National Defense Authorization Act for Fiscal Year 2003*, Public Law No. 107-314, § 1004, 116 Stat. 2629, 2 December 2002.

<sup>70</sup> General Accounting Office, *DoD Financial Management: Important Steps Underway But Reform Will Require a Long-term Commitment, Testimony, Before the Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform, House of Representatives* (Washington, D.C.: U.S. General Accounting Office, June 2002), 2.



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